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DEPARTMENT FOR EUR/SCE (ERIN KOTHEIMER AND YOULIANA IVANOVA)

PASS TO TREASURY FOR VIMAL ATUKORALA

E.O. 12958:N/A

TAGS: [ECON](#) [PGOV](#) [AL](#)

SUBJECT: Inflation Likely to Be Modest in 2008 as Albania's Economy  
Matures

#### Summary

¶1. Rising inflation in the second half of 2007 has stoked public anxiety in Albania, especially price increases for food. Although inflation will likely increase in 2008 over last year's rate of 3.0 percent, it is expected to stay within the GOA's target rate for inflation. End Summary.

#### Inflation: By the Numbers

¶2. After increasing by approximately 4 percent for the months of August, September and October, inflation cooled in November and December to an annual rate of 3.5 and 3.1 percent, respectively. The increases for food items - which represent the largest share in the basket of consumer goods and household staples used by the government to calculate the country's core inflation rate - were 6.9 and 5.4 percent respectively in November and December. During the prior three months when inflation reached 4 percent, food price increases averaged approximately 9 percent. The Central Bank has established a target rate for inflation between 2 and 4 percent and expects the annual average inflation rate to remain below 3.5 percent in 2008.

¶3. Inflation data is produced by INSTAT, the GOA's statistics office. However, INSTAT's reliability is widely distrusted, including by the opposition, which considers its data to be politically biased. (Note: The IMF and the European Commission have also criticized INSTAT's accuracy and lack of technical capacity.) A telling example of doubts over INSTAT's data is found in its reporting of price increases for bread in recent months. Anecdotal evidence confirmed by Embassy staff indicates that the price of bread, once a sensitive daily staple in Albania where price increases a decade ago triggered street riots - has risen by 40 percent, far more than what is officially reported.

#### Import Imbalance and Energy Increases Drive Inflation

¶4. Several factors are driving inflation. Price increases in Albania's small economy generally reflect worldwide trends, and global increases in commodity prices have rippled throughout the economy. Also, in 2007 an extended drought damaged domestic agricultural production. Drought conditions also reduced domestic electricity generation, forcing the country to import high priced electricity. The power crisis, coupled with the rise in the cost of fuel for back-up generators, has increased the cost of production in Albania for businesses. These factors, together with the rapid growth of commercial lending, have raised concerns about inflationary pressure. In response, the Central Bank increased the prime interest rate three times in 2007 - the last time in November

- to bring it to 6.25 percent.

¶5. Finance Minister Bode is unconvinced that inflation is a threat to the macroeconomic stability Albania has achieved over the last six years. Bode believes that the current increase is due to imported inflation, aggravated by Albania's dependence on foreign imports for a wide variety of products, and that the country's inflation rate is nonetheless low compared to neighboring countries.

A contrary opinion was given to the Embassy by the head of one of Albania's leading private banks. The banker said he expects inflation to spike up to six percent in 2008. The IMF is forecasting modest inflation for Albania this year between 2 and 4 percent per annum.

Comment

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¶6. Despite inflationary pressures caused by surging oil prices, Albania has largely been spared the inflationary effects of the oil price shock. Although Albania imports 75 percent of its petroleum needs, the doubling of dollar-denominated oil prices over the last two years has been offset by the lek's 30 percent appreciation against the dollar during this time period. Additionally, the lack of any public protest or political controversy over recent food price increases underscores the rapid economic development the country has enjoyed since its dramatic collapse in 1997. Albania, despite a daunting number of structural challenges to its future economic development, has evolved into a more normal country where an increasingly prosperous population can shrug off food price increases that would have led to instability in prior years. End

Comment.

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